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DIRECTORATE OF INTELLIGENCE

4 SEP 1985

MEMORANDUM FOR: Hazen F. Gale
Director, Office of Commodity Policy
Department of the Treasury

VIA: Douglas Mulholland
Office of Special Assistant to the
Secretary for National Security
Department of the Treasury

FROM: [REDACTED]
Acting Chief, Economics Division
Office of Global Issues

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SUBJECT: Perspective on Brazil's Announced Intention
to Deactivate the Brazilian Coffee
Institute (IBC) [REDACTED]

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The attached perspective on Brazil's announcement to deactivate the IBC
has been prepared in response to your request. I hope it proves to be
helpful. If we can be of further assistance or you have follow-up questions,
please call [REDACTED]

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Attachment:



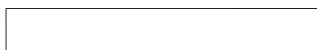
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SUBJECT: Perspective on Brazil's Announced Intention
to Deactivate the Brazilian Coffee Institute (IBC) ☐

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OGI/ECD/CM: ☐ (3 September 1985)

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DIRECTORATE OF INTELLIGENCE

4 September 1985

Perspective on Brazil's Announced Intention to Deactivate
the Brazilian Coffee Institute (IBC)Summary

Brasilia has recently announced that the Brazilian Coffee Institute (IBC) would be deactivated. The announcement follows an audit which found gross corruption and inefficiencies in the operation of the organization. The move could lead to higher prices for Brazilian coffee as discount sales are reduced and exporters are forced to finance a greater share of national stocks. Any major impact on global coffee prices, however, could be overshadowed by other events, such as the potential US pullout from the ICO (see attached paper). Over the longer term, without an IBC to coordinate and implement national programs and policies, Brazil's ability to mount a massive program to rebuild coffee production capacity as it did after the killer frost of July 1975 could be diminished. [redacted]

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This memorandum was prepared by [redacted] Commodity Markets Branch,
Office of Global Issues. The information contained herein is updated to
4 September 1985. Comments may be directed to [redacted], Acting Chief,
Economics Division, on [redacted]

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**Perspective on Brazil's Announced Intention to Deactivate
the Brazilian Coffee Institute (IBC)**

The Past: Functions and Policies of the IBC

The Brazilian Coffee Institute (IBC) is an autonomous agency within the Ministry of Industry and Commerce that is involved in all aspects of government support of the coffee sector. The IBC is currently chartered to assist in the maintenance of a balance between Brazil's coffee production, domestic consumption and trade. The IBC performs this function through technical assistance programs, provisions for producer credit and price support policies.

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Technical assistance in coffee production is provided by IBC staff research into new plant species with improved yield and disease resistant characteristics as well as dissemination of research findings on improved agronomic practices. Producer credit programs for growers have been sponsored through the Bank of Brazil, but those programs are inactive at this time.

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In its most important function, the IBC buys coffee from producers during periods of surplus crops and low world market prices through its minimum producer price program. To store surplus coffee the IBC maintains a domestic warehousing network with capacity estimated at 58 million bags. The IBC has also maintained warehouse capacity abroad in Hong Kong, Trieste, Hamburg and Beirut. IBC stocks are currently estimated at between 6 and 8 million bags, 60 kilograms each.

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The coffee purchased by the IBC is sold both for domestic use and export. The IBC generally sells coffee to domestic roasters and to the domestic soluble coffee industry at subsidized prices. As an incentive to the foreign roasters IBC also often offers coffee at reduced prices. For example, for volume buyers the IBC has provided from its overseas stocks 1 bag -- at a price lower than the market price -- for every 2 bags purchased at the regular export price. IBC export price policy is implemented through a minimum export registration price system. Currently the minimum export price for coffee of type 6 or better quality is \$1.22 per pound. At this price the IBC provides a bonus of up to 4 cents a pound for volume buyers.

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Coffee for export also is assessed an export tax by the IBC. The export tax or contribution quota has provided revenues for the Coffee Fund Account at the Central Bank. Currently the export tax is 37 percent of the export price. Revenues from the account were used in the 1960's in Brazil's significant coffee eradication program designed to reduce market depressing surplus coffee production and free coffee land for substitute crops. In the 1970's revenues from this account were used to fund the \$1 billion program to rebuild the coffee production capacity following the massive frost which hit Brazil in July 1975 killing millions of trees and spurring record prices. Coffee production dropped from 23 million bags in 1975 to 9 million bags in 1976, the first harvest after the frost.

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The Present: The Decision to Disband

Members of the new Neves/Sarney government have been highly critical of the performance of the IBC under its previous management. Upon taking office, the new Minister of Industry and Commerce Roberto Gusmao ordered a complete and impartial audit of IBC books to determine whether any irregularities had been committed. The audit released on 5 August revealed a devastating picture

of incompetence, irregularities and overmanning. The audit found, for example, that the IBC made costly mistakes through excessive price discounts and excessive hiring--4,000 employees when the auditors estimated 400 could have done the job. []

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With the release of the audit, Minister Gusmao announced that President Sarney had authorized him to gradually deactivate the administrative structure and functions of the IBC. Gusmao called the IBC an anachronistic, inert and static institution and indicated that it would be replaced by a foundation comprised of businessmen, producers and government officials. According to Gusmao, the deactivation process would begin in September with the meeting of a Mixed Commission to study current and future policies for the coffee sector. Gusmao has also stated he will dissolve all IBC offices outside Brazil within 30 days and would decide within 90 days whether to continue with the IBC internally or dissolve it in favor of a different type of organization to direct Brazil's coffee policy. Brasilia's objective, according to Gusmao, is to end IBC misuse of funds, corruption and inefficiency. []

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On 16 August, IBC President Karlos Rischbieter resigned reflecting a bitter clash with Minister Gusmao over the polemical manner the Minister was handling the IBC deactivation issue. To fill the vacancy left by Rischbieter, President Sarney last week named career diplomat Carlos Alberto Leite Barbosa as the new head of the IBC. Leite Barbosa had been serving as Brazil's ambassador to Colombia at the time of his appointment. According to

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press reports, Leite Barbosa is regarded as the leading coffee specialist in Itamaraty--the Brazilian Foreign Ministry.

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In statements made since his appointment, Leite Barbosa has stressed that the IBC will be reformed--not completely dissolved. Leite Barbosa's most important immediate task will be to restore a sense of confidence and direction to Brazil's internal and international coffee policy. Both Leite Barbosa and Minister Gusmao have emphasized that Brazil will maintain membership in the International Coffee Organization (ICO) and honor all commitments signed related to the agreement. Nonetheless, with less than three weeks remaining before the annual ICO Council meeting in London, the IBC announcements have shaken an already divided organization. Consumer members have expressed considerable displeasure with the functioning of the ICO owing to the growth in a 2-tier price system for coffee with producers selling to consumer members at prices double those to non-members. In addition to this issue the Council will face the difficult task of setting export quotas for the 1985/86 coffee year to begin 1 October.

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The Future: What Would Replace the IBC

If the IBC is broken-up, the current research, warehousing and export promotion functions of the IBC would have to be divided among different existing entities. Research and extension services could be picked up by the Ministry of Agriculture and state agricultural agencies such as the Institute of Agronomy, Secretariate of Agriculture for the State of Sao Paulo; warehousing administration could be shifted to Brazil's Warehousing and Trading Company (COBEC). The director of CACEX--the Foreign Trade Department of the Bank of Brazil--has stated that his organization was prepared to take over certain functions of the IBC.

That portion of export sales now handled by the IBC could be taken up by a private sector already experienced and capable of expanded marketing responsibilities. Actual coffee production would remain with the nation's coffee growers who already decide on levels of production in a free market setting. While subsidized credit is not available for expansion of coffee plantings, fairly attractive prices have recently created a demand for privately financed coffee seedlings in key growing areas.

Implications for the Coffee Industry

The coffee trade has reacted apprehensively to the news from Brazil as shown in recent strengthening in futures prices. Some roasters fear that the proposed transformation of the IBC would mean an end to the discount prices that they have been getting. The uncertainty is compounded by Brazil's new coffee retention plan whereby exporters are required to stock 2 bags of coffee for every 1 bag exported. The retention plan effectively transfers the burden of stock financing--traditionally shouldered by the IBC--onto individual exporters. This policy is expected to lead to increased prices for Brazilian coffee as exporters are forced to pass on higher overhead costs to importers. []

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From a longer term perspective, we believe the future ability of Brazil to cope with a frost of the magnitude of July 1975 without an IBC to coordinate a massive recovery program and a Coffee Fund to provide financing may be diminished. It is our understanding that coffee export tax revenues are currently funneled into general revenues in contrast to the 1970s when revenues from the tax were earmarked for the coffee sector. US coffee experts credit the IBC with saving the international coffee industry by its bold \$1 billion program to rebuild Brazil's coffee production capacity after the 1975 frost. If another frost of the same magnitude hit, Brazil may not have the wherewithall or commitment to rebuild the coffee industry, especially in light of its current debt service commitments. []

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With respect to the ICO, it appears clear that Brazil's commitment to this organization whose export quota system and price stabilization measures have served it and Colombia so well will remain undaunted. Ruffled relations with Colombia on coffee policy have been soothed, especially with the naming of Brazil's former Ambassador to Colombia Leite Barbosa to head the IBC during

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its transformation. For consuming countries, the possible elimination of Brazil's overseas warehousing may reduce leakage of coffee destined for non-member countries into member countries at discounted prices. This may aid in a partial resolution of the two-tier pricing issue.

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Of more importance to the short-term course of world coffee prices, however, is the potential US pullout from the ICO. Should this event occur, we believe coffee prices received by ICO exporters could drop 20-30 cents a pound, an outcome that would severely complicate Brazil's actions on the IBC.

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